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FISCAL IMPACT STATEMENT

LS 7877 | **NOTE PREPARED:** Jan 28, 2007
BILL NUMBER: SB 577 | **BILL AMENDED:**

SUBJECT: Lottery.

FIRST AUTHOR: Sen. Merritt | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State
X **DEDICATED**
FEDERAL

Summary of Legislation: The bill authorizes the State Lottery Commission, the Indiana Gaming Commission, and the Indiana Finance Authority to enter into a management agreement for the operation of the lottery. It establishes the Hoosier Hope Scholarship Program and the World Class Scholar Program. It also makes an appropriation.

Effective Date: Upon passage.

Explanation of State Expenditures: *Lottery Management Agreement:* The bill authorizes the Indiana Lottery Commission, the Indiana Gaming Commission (IGC), and the Indiana Finance Authority (IFA) to enter into an agreement with a private entity (established as a domestic corporation or limited liability company under the bill) that would manage all aspects of the Hoosier Lottery for an initial term of up to 30 years. The bill provides for the following with regard to private management of the Hoosier Lottery:

(1) The lottery manager under the lottery management agreement would be prohibited from conducting the following games: keno, video lottery games, pari-mutuel wagering on horse or dog racing, betting on races or sporting events, or any other game that is not a game that the IGC is authorized to approve under the State Lottery Law.

(2) A requirement that the lottery manager makes an initial lump sum payment of at least $1,000.0 M to the state on the effective date of the management agreement.

(3) A requirement that the lottery manager annually make royalty payments to the state totaling at least $200.0 M.

Management Agreement Provisions: The bill specifies various requirements that the management agreement must address, including: (1) required implementation by the lottery manager of a security program, a system of internal audits, and a program to curb compulsive gambling by lottery players; (2) operational requirements for games including minimum payouts; (3) advertising and promotion requirements; (4) IGC monitoring requirements; (5) requirements for filing appropriate financial statements; (6) cash reserve requirements; (7) grounds for terminating the management agreement by the IGC or the lottery manager; and (8) procedures for amending the management agreement.

Process for Selecting Lottery Manager: The bill outlines the process for selecting a lottery manager and for negotiating the management agreement. The bill requires the Lottery Commission, the IGC, and the IFA to issue a request for qualifications (RFQ) from potential lottery managers. The RFQ process is to be conducted by the IFA. (Note: The RFQ was issued by the IFA on January 2, 2007, with the deadline for responding to the RFQ set for January 29, 2007.) The bill authorizes the IFA to negotiate with one or more entities offering proposals during the RFQ process to obtain final offers on the management agreement. The bill specifies criteria for determining whether to negotiate with an offeror, and also specifies requirements and criteria to be utilized by the IFA in selecting an offeror as the lottery manager. Once the IFA has made a preliminary selection, the IGC must hold a public hearing on the offeror selected. The notice for this hearing must disclose the identity of the selected offeror and that information on the selected offer and the basis for its selection are available to the public. After the hearing, if the IGC determines that a management agreement should be entered into with offeror it must submit the determination to the Governor and the State Budget Committee. The bill allows the Governor to accept the IGC's determination and designate the offeror as the lottery manager, once the Budget Committee has reviewed the IGC's determination.

Indiana Gaming Commission Responsibilities: Under the bill, the IGC is responsible for the ongoing oversight and evaluation of the lottery manager. In the event that a management agreement is entered into, the bill provides for the transfer of all powers, duties, and liabilities of the Lottery Commission to the IGC as the successor agency. The bill requires that the lottery manager undergo a complete investigation by the IGC every three years. The cost of the investigation is to be paid by the lottery manager. The bill also requires the IGC to conduct an evaluation of the lottery manager's security program in the first year of the agreement every two years thereafter. The bill establishes a license for vendors of various lottery equipment to be issued by the IGC. The bill requires the IGC to conduct an investigation of a vendor every three years and requires the licensee to pay the cost of these investigations. The bill also requires a vendors licensee to pay an annual license fee set by the IGC.

The bill authorizes the IGC to employ personnel to perform its duties relating to licensing lottery vendors or oversight of the lottery manager, or to utilize personnel employed for purposes of administration and regulation of riverboat gambling on these duties. Aside from vendors license fees and investigative cost reimbursement requirements, the bill does not provide for additional funding to the IGC to cover the administrative cost of overseeing the lottery manager's performance.

Payback of Debt or Loans by Indiana Gaming Commission: The bill authorizes the IGC to pay amounts it owes under the management agreement from any funds available to the IGC and borrow money form the IFA to pay any such amounts owed. The bill also provides for the management agreement, or any loan or financing arrangement, to establish a procedure for the IGC to certify the amounts owed to the General Assembly or to create a moral obligation of the state to pay the amounts owed by the IGC under the management agreement, or loan or financing arrangement. These elements would be subject to the review of the State Budget Committee and approval of the State Budget Director.

Management Agreement Trust Fund: Under the bill, the Lottery Commission would continue to exist, however, its primary responsibility would be to administer the Management Agreement Trust Fund established by the bill. This Fund is nonreverting and consists of the following money:

(1) Any amount of the initial lump sum payment required from the lottery manager exceeding $1,000.0 M. This money must be deposited in the Hoosier Hope Account within the Fund.

(2) The royalty payments of at least $200.0 M annually required from the lottery manager. This money must be deposited in the Management Agreement Royalty Account within the Fund.

(3) Appropriations, grants and gifts, and investment earnings.

<u>The bill requires transfers to the Teachers' Retirement Fund totaling $30.0 M annually; the Pension Relief Fund totaling $30.0 M annually; and the Build Indiana Fund totaling $140.0 M annually.</u> Under current statute, surplus Lottery revenue in the Lottery Commission's Administrative Trust Fund is first transferred to the Teachers' Retirement Fund ($30.0 M annually) and the Pension Relief Fund ($30.0 M annually). Once these transfers are made, the remaining surplus Lottery revenue is distributed to the Build Indiana Fund (BIF). The residual transfer to the BIF from the Administrative Trust Fund totaled $149.9 M in FY 2006, with the transfer averaging about $140.0 M from FY 2004 to FY 2006.

The bill provides that money remaining in the Fund at the end the fiscal year must be transferred to the Hoosier Hope Scholarship Fund (see explanation below).

Hoosier Hope Scholarship Program: The bill establishes the Hoosier Hope Scholarship Program and requires the State Student Assistance Commission of Indiana (SSACI) to administer the scholarship program. Grants provided to students under the scholarship program are to be funding with investment earnings from the principal amount deposited in the Hoosier Hope Trust Fund. The State Treasurer is required to annually transfer these investment earnings from the Trust Fund to the Hoosier Hope Scholarship Fund. Scholarship grants are to be paid by SSACI from this Fund. <u>The initial principal amount deposited in the Trust Fund would total $600.0 M (60% of the minimum initial lump sum payment of $1,000.0 M required by the bill from the lottery manager).</u> <u>This principal amount could potentially generate about $31.0 M annually for the scholarship program assuming a 5% return on investment compounded daily.</u>

The annual earnings total would provide $6.2 M for grants to students in associate degree programs assuming 20% of the total is allocated to associate degree grants as required by the bill. This would provide 2,480 scholarship grants totaling $2,500 each to students in associate degree programs. The remainder of the annual earnings total $24.8 M would provide 4,960 scholarship grants totaling $5,000 each to students in baccalaureate degree programs.

World Class Scholar Grant Program: The bill establishes the World Class Scholars Program and establishes a Board to award matching grants to state institutions of higher education under the program. The matching grants would be funded with the principal amount and investment earnings deposited in the World Class Scholars Fund. The Fund is to be administered by the Commission for Higher Education and the bill requires the Commission to provide administrative support to the Board. Board members may receive a per diem allowance and reimbursement for expenses for serving on the Board. The bill authorizes the Board to use money in the Fund to pay the administrative expenses incurred by the Board. <u>The initial principal amount deposited in the World Class Scholars Fund would total $400.0 M (40% of the minimum initial lump sum payment of $1,000.0 M required by the bill from the lottery manager). The table below outlines the amounts</u>

available each year for grants over a 10-year period assuming the Board uses $40 M in principal at the end of each year plus the investment earnings on the Fund during that year for matching grants. The investment earnings computed for each year assume 5% return on investment compounded daily.

Principal and Investment Earnings Available Annually Assuming Annual Expenditure of $40 M in Principal and 5% Return on Investment		
Principal Amount	**Investment Earnings**	**Amount Available for Matching Grants**
$400.0 M	$20.5 M	$60.5 M
360.0 M	18.5 M	58.5 M
320.0 M	16.4 M	56.4 M
280.0 M	14.4 M	54.4 M
240.0 M	12.3 M	52.3 M
200.0 M	10.3 M	50.3 M
160.0 M	8.2 M	48.2 M
120.0 M	6.2 M	46.2 M
80.0 M	4.1 M	44.1 M
40.0 M	2.1 M	42.1 M

Background on the Hoosier Lottery: The Indiana Lottery Commission is established under current statute as a body politic and corporate separate from the state. Lottery Commission is composed of five members. The January 1, 2007, state staffing table indicates that the Hoosier Lottery currently employs 164 people with a salary component totaling about $6.9 M. The Hoosier Lottery has a total of 213 budgeted positions, with 49 vacant full-time positions.

The Hoosier Lottery commenced sales of instant scratch-off tickets on October 13, 1989. Since that time the Hoosier Lottery has offered a variety of draw games and instant ticket games. From FY 2000 to FY 2005 (the most recent data available) the share of annual sales revenue attributable to instant ticket games has increased from about 57.4% to about 66.2%. Annual sales and net income generated by the Hoosier Lottery is summarized in the table below. Sales totals have experienced average annual growth of about 4.5% since FY 1990 (the Lottery's first year of operation) and 5.8% since FY 2000. FY 2006 sales exceeded FY 2005 sales by 10.4%. Net income generated by the Hoosier Lottery has grown by an annual average of 3.2% since FY 1990 and 4.6% since FY 2000. Net income in FY 2006 exceeded FY 2005 net income by 14.6%.

Hoosier Lottery Sales and Net Income History			
Fiscal Year	**Sales**	**Net Income**	**Profit**
1990	$403.1 M	$130.7 M	32.4%
1991	446.5 M	151.2 M	33.9%
1992	390.1 M	116.2 M	29.8%
1993	513.4 M	146.1 M	28.5%
1994	575.2 M	165.3 M	28.7%
1995	610.7 M	183.2 M	30.0%
1996	621.3 M	188.1 M	30.3%
1997	578.9 M	176.4 M	30.5%
1998	648.2 M	195.5 M	30.2%
1999	681.0 M	204.0 M	30.0%
2000	582.5 M	165.4 M	28.4%
2001	548.3 M	155.6 M	28.4%
2002	626.3 M	167.4 M	26.7%
2003	664.4 M	175.6 M	26.4%
2004	734.9 M	199.3 M	27.1%
2005	739.6 M	189.0 M	25.6%
2006	816.4 M	216.6 M	26.5%
Source: FY 1990 to FY 2005 totals are from the Hoosier Lottery Commission annual audited financial statements. The FY 2006 sales total is from the *Hoosier Lottery Request for Lottery License Qualifications* and the net income total is an unaudited total from the *FY 2006 Indiana Handbook of Taxes, Revenues, and Appropriations*.			

Background on the Hoosier Hope Scholarship Program: Funding Scheme: The Hoosier Hope Trust Fund consists of a principal amount from the initial lump sum payment that is required of the private Hoosier Lottery manager on the effective date of the management agreement between the manager and the state. The Trust Fund also receives investment earnings on the principal throughout the year. The bill specifies that the initial lump sum payment Hoosier Lottery manager must total at least $1,000.0 M. The bill requires 60% of this initial payment to be transferred to the Trust Fund.

The bill requires the Chairman of the Indiana Finance Authority (IFA) to enter into an irrevocable trust agreement with the State Treasurer who will act as trustee of the money in the Hoosier Hope Trust Fund. The bill provides for the investment of the money in the Trust Fund by the State Treasurer. The Trust Fund is nonreverting and all investment income from the principal in the Trust Fund must be deposited in the Trust

Fund. The bill prohibits the principal in the Trust Fund from being diminished during the term of the trust. The bill requires the State Treasurer, every July 1st beginning in 2008, to transfer all the investment earnings generated by the principal in the Trust Fund during the preceding fiscal year to the Hoosier Hope Scholarship Fund from which the Hoosier Hope Scholarship grants would be paid.

The Hoosier Hope Scholarship Fund is to be administered by SSACI, with administrative expenses paid form money in the Fund. The Fund consists of the investment earnings transfers, and appropriations, grants and gifts, and investment earnings on the money in the Fund. The Fund is nonreverting and money in the Fund is continuously appropriated to SSACI for grants. The bill prohibits money in the Fund from being transferred, assigned, or otherwise removed from the Fund by the State Board of Finance, the State Budget Agency, or any state agency other than SSACI.

Scholarship Program: The bill authorizes SSACI to provide grants equal to: (1) $2,500 per academic year for up to two years for a qualified individual enrolled full-time in an associate degree program at a state educational institution or private institution of higher education in Indiana; and (2) $5,000 per academic year for up to four years for a qualified individual enrolled full-time in baccalaureate degree program at a state educational institution or private institution of higher education in Indiana. The bill provides that SSACI determine the amount of each grant awarded under the program, and limits the total amount of grants awarded to an individual to $20,000. The bill requires at least 20% of the grants annually to be made to students in associate degree programs. The grant may be used to pay tuition, fees, books, supplies and equipment required by the educational institution for enrollment or attendance. Individuals seeking a grant under the scholarship program must apply to SSACI and meet the following requirements:

(1) be an Indiana resident;
(2) be enrolled in the 12th grade or its equivalent at a public or nonpublic accredited school, or nonaccredited nonpublic school, in Indiana;
(3) qualify as an outstanding scholar under criteria established by SSACI;
(4) intend to pursue a baccalaureate or associate degree at a state educational institution or private institution of higher education in Indiana;
(5) intend to reside in Indiana for at least three years following attainment of the degree; and
(6) fulfill any other requirements established by SSACI.

The bill also provides for SSACI to:

(1) establish criteria for being an outstanding scholar and requires the criteria to include SAT or ACT scores and cumulative GPA of applicants;
(2) develop criteria governing the acceptance into the program of applicants enrolled in nonaccredited nonpublic schools; and
(3) procedures for annual renewal of grants under the scholarship program and requires that the recipient must remain enrolled full-time and maintain at least 3.0 GPA on a 4.0 grading scale or its equivalent.

The bill requires the grant recipient to repay SSACI the entire grant received if the recipient fails to: (1) complete the degree program within the time allotted for completing the degree program by the educational institution; or (2) reside in Indian and maintain qualified employment for three years following the year in which the recipient attained the degree. The bill provides that repayment may be waived or deferred in the case of disability, illness, or other extenuating circumstances; or may grant a deferment in the case of the recipient fulfilling a military obligation.

Background on World Class Scholar Grant Program: Funding Scheme: The World Class Scholars Fund consists of a principal amount from the initial lump sum payment that is required of the private Hoosier Lottery manager on the effective date of the management agreement between the manager and the state. The Fund also receives investment earnings on the principal throughout the year. The bill specifies that the initial lump sum payment Hoosier Lottery manager must total at least $1,000.0 M. The bill requires 40% of this initial payment to be transferred to the Fund. The bill provides that the Fund also consists of appropriations, grants and gifts, and investment earnings on the money in the Fund.

Grant Program: The bill establishes the World Class Scholars Fund Board to receive, review, and recommend applications for matching grants to state institutions of higher education to recruit and retain a "world class scholar" (a principal researcher/investigator or distinguished faculty member of national or international renown who has high academic credentials, demonstrated competence, and experience that meet criteria established by the Board). The Board is also required to develop a 10-year plan to distribute the principal and interest in the World Class Scholars Fund to award these grants. The Board consists of 10 members including the Governor or the Governor's designee. The remaining Board members are appointed by the Governor to two-year terms.

The bill authorizes a state institution of higher education to apply for grants from the Board. The grants may be used by an institution to recruit and retain "world class scholars" by: (1) endowing a chair at the institution; (2) establishing or enhancing research facilities and laboratories and providing specialized equipment to conduct research; (3) enter into collaborative arrangements with the private sector, private educational institutions, or other state educational institutions. The bill requires the Board to establish criteria and an application procedure for awarding the grants. The bill also requires the state higher education institution to provide matching funds in an amount that meets or exceeds the amount of the grant.

Prohibited Political Contributions: The bill prohibits the lottery manager or a person who has an interest in the lottery manager to make a political contribution to a candidate or candidate's committee during the term of the lottery management agreement or three years following the expiration of that management agreement. A Class D felony is punishable by a prison term ranging from six months to three years or reduction to Class A misdemeanor, depending upon mitigating and aggravating circumstances. The average expenditure to house an adult offender was $22,734 in FY 2006. (This does not include the cost of new construction.) If offenders can be housed in existing facilities with no additional staff, the average cost for medical care, food, and clothing is approximately $1,825 annually, or $5 daily, per prisoner. The estimated average cost of housing a juvenile in a state juvenile facility was $63,139. The average length of stay in DOC facilities for all Class D felony offenders is approximately ten months.

Explanation of State Revenues: *Lottery Management Agreement:* The bill authorizes the Indiana Lottery Commission, the Indiana Gaming Commission (IGC), and the Indiana Finance Authority (IFA) to enter into an agreement with a private entity (established as a domestic corporation or limited liability company under the bill) that would manage all aspects of the Hoosier Lottery for an initial term of up to 30 years. The bill provides that the lottery management agreement must require the lottery manager to:

(1) make an initial lump sum payment of at least $1,000.0 M to the state on the effective date of the management agreement.

(3) annually make royalty payments to the state totaling at least $200.0 M.

A description of the purposes to which these revenues are to be distributed is contained in the

Explanation of State Expenditures.

Income Tax for Lottery Manager: The bill requires the lottery manager to form as a domestic corporation or limited liability company and locate its principal office within Indiana. As a result, the lottery manager's income generated from the lottery management agreement would be subject to taxation in the same manner as income received by other private entities. The potential revenue impact of this operation is indeterminable.

Prohibited Political Contributions: If additional court cases occur and fines are collected, revenue to both the Common School Fund and the state General Fund would increase. The maximum fine for a Class D felony is $10,000. Criminal fines are deposited in the Common School Fund.

If the case is filed in a circuit, superior, or county court, 70% of the $120 criminal costs fee that is assessed and collected when a guilty verdict is entered would be deposited in the state General Fund. If the case is filed in a city or town court, 55% of the fee would be deposited in the state General Fund. In addition, some or all of the judicial salaries fee ($15), the public defense administration fee ($3), the court administration fee ($2), the judicial insurance adjustment fee ($1), and the DNA sample processing fee ($1) are deposited into the state General Fund.

Explanation of Local Expenditures: *Prohibited Political Contributions:* If more defendants are detained in county jails prior to their court hearings, local expenditures for jail operations may increase. The average cost per day is approximately $44.

Explanation of Local Revenues: *Prohibited Political Contributions:* If additional court actions occur and a guilty verdict is entered, local governments would receive revenue from the following sources: The county general fund would receive 27% of the $120 criminal costs fee that is assessed in a court of record. Cities and towns maintaining a law enforcement agency that prosecutes at least 50% of its ordinance violations in a court of record may receive 3% of the criminal costs fee. In addition, several additional fees may be collected at the discretion of the judge and depending upon the particular type of criminal case.

State Agencies Affected: State Lottery Commission; Indiana Finance Authority; Indiana Gaming Commission; State Student Assistance Commission of Indiana; State Higher Education Commission; State Educational Institutions; Treasurer of State; State Budget Agency; State Budget Committee; Department of Correction.

Local Agencies Affected: Trial courts, local law enforcement agencies.

Information Sources: Hoosier Lottery, Annual Audited Financial Statements; Tim Kuehr, Hoosier Lottery, (317) 264-4611; Indiana Legislative Services Agency, FY 2006 Indiana Handbook of Taxes, Revenues, and Appropriations;. Indiana Finance Authority, *Hoosier Lottery Request for Lottery License Qualifications*, January 2, 2007; Indiana Sheriffs' Association; Department of Correction.

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